INDEX

CITATIONS

Cases:

Cases—Continued

In the Supreme Court of the United States

OCTOBER TERM, 1949

No. 55

MANUFACTURERS TRUST COMPANY, AS TRUSTEE UNDER AN INDENTURE MADE BY THE DEBTOR UNDER DATE OF SEPTEMBER 27, 1933, AND INDIVIDUALLY, PETITIONER

v.

REGINE BECKER, EMILY K. BECKER, AND WALTER A. FRIBOURG

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR THE SECURITIES AND EXCHANGE COMMISSION, AMICUS CURIAE, IN SUPPORT OF PETITIONER

INTRODUCTORY STATEMENT

Although this appeal arises under Chapter XI of the Bankruptcy Act, the Commission is submitting this brief as *amicus curiae* since it is of the opinion that the determination of the questions involved herein will have an important bearing on

similar questions arising under Chapter X of the Bankruptcy Act in proceedings to which it may be a party.[1]

OPINIONS BELOW

The opinion of the court of appeals (R. 175-188) is reported at 173 F. 2d 944. The opinion of the district court (R. 91-95) is reported at 80 F. Supp. 822.

JURISDICTION

The judgment of the court of appeals was entered on March 3, 1949 (R. 189). The petition for a writ of certiorari was filed on April 20, 1949, and granted on June 6, 1949 (R. 189). The jurisdiction of this Court is invoked under 28 U.S.C. 1254.

QUESTIONS PRESENTED

1. May a director who has purchased claims against his corporation for a fraction of their face amount during the insolvency of the corporation be permitted to profit thereon in a proceeding under the Bankruptcy Act subsequently initiated by the debtor?

2. Assuming that distribution to a director in the above situation would be limited to cost, does a

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[1] At the present time, questions similar to those presented here are involved in several Chapter X reorganizations to which this Commission is a party; purchases by a fiduciary during insolvency of the company are involved in *In re Drake Stadium and Field House Corp.*, No. 9758 (S.D. Ia.); family relationships are involved in *In re Chicago Rapid Transit Co.*, No. 65,037 (N.D. Ill.); both of these issues are involved in *In re Wade Park Manor Corp.*, No. 64,870 (N.D. Ohio); and in *In re Franklin Building Company*, 83 F. Supp. 263 (E.D. Wis.), appeals pending in C.A. 7.

different rule apply where the purchases were made (a) in the sole discretion of the director acting as agent for his wife and mother, or (b) with the assistance of the director by his office associate?

STATEMENT

The facts are set forth in the briefs filed by the parties. For purposes of this brief, we note merely that the court below found that the debtor, Calton Crescent, Inc., was insolvent during the entire period when the purchases of the claims involved here were made—a four-year period preceding the filing of the voluntary petition under Chapter XI of the Bankruptcy Act; that the purchases of the respondents Regine and Emily K. Becker (the mother and wife, respectively, of a director) were made with their own funds by the director without these ladies' exercising any independent judgment in the investment; that the purchases made by respondent Fribourg, office associate of the directors of the debtor, were made with his own funds upon information furnished by the directors; that in all of these purchases there was no evidence of any wrongful overreaching or concealment; and that all of the securities acquired as a result of these purchases were allowed to participate without limitation, on a parity with the holdings of public security holders.

ARGUMENT.

I

A Director Who Has Purchased Claims Against His Corporation for a Fraction of Their Face Amount During the Insolvency of the Corporation Cannot Profit Thereon in Proceedings under the Bankruptcy Act Subsequently Initiated by the Debtor [2]

The prevailing rule in the federal courts, with which the decision below in our view conflicts, is that during the insolvency of a corporation its directors and officers may not profit by trading in claims against the company.[3] The court below did not directly repudiate this rule but, by reason of what we believe to be a misapprehension of its purpose, has grafted onto the rule an unwarranted exception. The exception would limit the application of the rule, in cases where the purchases occurred prior to the commencement or imminence

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[2] Although there are no claims filed in this case by directors which were purchased during the insolvency of the corporation and which would therefore be subject to the rule limiting participation on such claims to cost in subsequent bankruptcy proceedings, it is necessary to establish this proposition in order to determine the ultimate question involved herein whether the rule should be held applicable to the claims of the wife, mother and office associate of the director.

[3] *In re Norcor Mfg. Co.*, 109 F. 2d 407, 411 (C.A. 7), certiorari denied, 310 U.S. 625; *In re The Van Sweringen Co.*, 119 F. 2d 231, 234 (C.A. 6), certiorari denied *sub nom. Terminal & Shaker Heights Realty Co.* v. *The Van Sweringen Co.*, 314 U.S. 671; *In re Los Angeles Lumber Products Co.*, 46 F. Supp. 77 (S.D. Cal.); *In re Jersey Materials Co.*, 50 F. Supp. 428 (D. N.J.); *Pepper* v. *Litton*, 308 U.S. 295, 311; *Woods* v. *City National Bank and Trust Co.*, 312 U.S. 262, 268-269; *Monroe* v. *Scofield*, 135 F. 2d 725 (C.A. 10); *In re Philadelphia & Western Ry. Co.*, 64 F. Supp. 738 (E.D. Pa); *In re McCrory Stores Corp.*, 12 F. Supp. 267, 269 (S.D. N.Y.).

of bankruptcy proceedings, to situations where there is proof of overreaching or concealment by the director, or where there is a showing of injury either to the corporation or the selling creditors. This exception appears to derive, in part, from a conception that the rule is solely related to the protection of selling security holders against their management.

In our view, however, the ultimate purpose of the rule is to prevent fiduciaries from placing themselves in a position where they may be tempted to violate their obligation of undivided loyalty.[4] Its immediate objective is to prevent the directors from trading in its corporate obligations when, because of insolvency, they are fiduciaries to all security holders of the corporation.[5] It is an application of the principle of the law of trusts which was set forth by this Court as follows in *Magruder* v. *Drury*, 235 U. S. 106, 119:

> It is a well settled rule that a trustee can make no profit out of his trust. The rule in such cases springs from his duty to protect the interests of the estate, and not to permit his personal interest to in any wise conflict with

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[4] *Cf. Woods* v. *City National Bank and Trust Co.*, 312 U.S. 262, 268. There are other doctrines, remedial in nature, as illustrated by *Strong* v. *Repide*, 213 U. S. 419, and *Taylor* v. *Standard Gas & Electric Co.*, 306 U.S. 307, which are designed to give relief to parties injured by overreaching, concealment or mismanagement by fiduciaries and it is significant that these doctrines are applicable whether or not the corporation was solvent or insolvent when the breach of fiduciary duty occurred.

[5] *Pepper* v. *Litton*, 308 U.S. 295.

his duty in that respect. The intention is to provide against any possible selfish interest exercising an influence which can interfere with the faithful discharge of the duty which is owing in a fiduciary capacity.

The court below recognized but failed, we believe, to make a realistic application of that principle. A director clearly owes to an insolvent corporation a duty to take whatever steps may be necessary best to protect its security holders. These steps may well be inconsistent with what would be most advantageous for a director acquiring the debt securities of the corporation. As an insider, he is in an unique position to assess the value of the claims against the corporation and if the market should assess this claim at a lower value, he may find it advantageous, for example, to adopt measures to stave off bankruptcy proceedings so that he can continue his purchase program. The immediate institution of proceedings, however, might be in the best interests of the debtor's security holders, since it might release the corporation from onerous contracts or otherwise prevent its assets from being wasted. The broad area of "business judgment" in which a director may act and the impossibility of proving what might have resulted had different steps been taken [6] normally make it impossible to show that a director intentionally sabotaged his

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[6] *Cf. Taylor* v. *Standard Gas & Electric Co.*, 306 U.S. 307, 323.

corporation to achieve a personal gain—and indeed, in a particular case it might appear in the light of hindsight that the action of the director has turned out in the best interests of the security holders of the corporation. This possible coincidence, however, is insufficient protection for the insolvent corporation's security holders who are entitled to have their fiduciaries act without being influenced in any respect by considerations as to their own personal advantage or disadvantage.

Contrary to the holding below, we believe that there is no sound distinction between purchases during the period when bankruptcy proceedings are "contemplated" and during the period of insolvency preceding such contemplation. The court below apparently used the term "contemplated" to apply to situations where a decision has already been reached to institute the proceedings or at least the individual fiduciary expects that action to be taken after a contemplated meeting of the board of directors. It should be noted, however, that in a very real sense reorganization proceedings necessarily are contemplated from the moment that insolvency occurs because that is clearly one of the few possibilities open to the corporation. It is at this time that the directors must become concerned not only with the normal running of the corporation but also with the steps necessary for rehabilitation or for equitable distribution of the corporate assets. Whether the interests of the corporation

nd its security holders will best be served by a ebt adjustment through negotiation or by proeedings under the Bankruptcy Act or other atutes should be determined without reference to ne self-interest which the securities purchase proram of a director would motivate.[7] Indeed, such ifferences as do exist between the period of inolvency preceding bankruptcy and the period when ankruptcy proceedings are pending actually make more essential that the rule be applied during the ormer period. After proceedings are instituted ne court becomes the guardian of the debtor's afirs and the corporation and the entire communy of interests it represents have the protection of udicial surveillance and supervision, which is ab-

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[7] We recognize that it is possible for a director to be ibject to conflicting interests even when the corporation mains solvent, and similarly, a conflict of interests may ise after insolvency as a result of purchases of securities ade prior thereto. These dangers have never been regarded courts of equity as sufficient to justify a change in the mmon-law rule which permits directors to trade freely in e securities of solvent corporations so long as they indulge no overreaching or other fraudulent acts. See *Securities and rchange Commission* v. *Chenery Corp.*, 318 U.S. 80, *Strong* v. *epide*, 213 U.S. 419, and *Hotchkiss* v. *Fischer*, 136 Kan. 530, P. 2d 531 (1932). However, compare Section 16(b) of e Securities Exchange Act of 1934, 15 U.S.C. § 78p(b), hich, in recognition of the difficult problems relating to the fair use of inside information, categorically prohibits direcrs, officers and other "insiders" of corporations with listed curities from taking any profit on "quick-turn" transaction the equity securities of their corporation. In any ent, the fact that the rule has not been applied to iminate all of the potential temptations to divide his loyalty nich may arise for a director is no sound reason for limiting still further in a situation where it is clearly applicable.

sent during the period of insolvency preceding the institution of proceedings.

The only circumstance that the court below pointed to as indicating that the rule of limitation to cost should not be applied prior to the institution of bankruptcy proceedings or the "contemplation" thereof is the fact that most of the cases applying the rule involved claims purchased "after some type of bankruptcy proceeding was pending or was imminent and known to be so by the director." (173 F. 2d at 950.) None of these cases, however, made this an indispensable basis for invoking the rule, and the opinions uniformly state the rule in terms of insolvency.[8] Moreover, there are cases in which the rule has been applied where the claims had been purchased before bankruptcy proceedings were commenced, or contemplated in the sense that it had been determined to institute proceedings.[9] Indeed the rule has been applied where no bankruptcy or reorganization proceedings were ever involved. See *Bramblet* v. *Commonwealth*

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[8] See cases in note 3, *supra*.

[9] *In re The Van Sweringen Co.*, 119 F. 2d 231 (C.A. 6), certiorari denied *sub nom. Terminal & Shaker Heights Realty Co. v. The Van Sweringen Co.*, 314 U.S. 671 (purchases made a full year prior to the filing of a voluntary petition, as indicated in related case of *Gochenour* v. *Cleveland Terminals Building Co.*, 142 F. 2d 991, 992 (C.A. 6), certiorari denied, 323 U.S. 767); *In re Jersey Materials Co.*, 50 F. Supp. 428 (D. N.J.), (purchases made five months before the filing of an involuntary petition). *Cf. In re Norcor Mfg. Co.*, 109 F. 2d 407 (C.A. 7), certiorari denied, 310 U.S. 625, where the purchases were made during a period commencing two and one-half years prior to the filing of an involuntary petition, but during a state court receivership.

Land & Lumber Co., 26 Ky. L. Rep. 1176, 83 S.W. 599, 602 (1904), where the court said:

> We have no hesitancy in declaring the law to be that a president of an insolvent and failing corporation cannot traffic in its property to his advantage and to its disadvantage, or buy in debts against it at heavy discount and then assert them for full value. To the argument that it does not matter to the corporation who owns its debts, so it honestly owes them, and that it is immaterial to it whether its president gets them for nothing, as it does not have to pay any more than it actually owes in any event, the answer is, it does matter, for human nature is not so constituted that the same person can fairly represent opposing sides of the same question—cannot be both creditor and debtor. The corporation was entitled to the untrammeled judgment and efforts of its president in administering its affairs in its behalf exclusively. When he assumed an attitude wherein his personal interest came into conflict with his duty to his corporation—where he would be tempted to serve it less diligently in order that he personally might profit by his relaxation of official vigilance—his disloyal act to his company will be turned aside from his pocket, and the profits of his speculation will be turned into the corporation. The policy of the law is to insure fidelity of trustees to their trusts by making it impossible for them to profitably neglect or abuse them. Whether the derelict officer acts from a mistaken notion of his

rights, or from an actually fraudulent purpose, is immaterial, as affecting the invalidity of the transaction. The principle is too well settled to require elaboration.

Judges have frequently warned against the temptation to relax the rigidity of the rule that fiduciaries may not be permitted to profit where their personal interests may conflict with those of their cestuis in cases where the trustee has appeared to act in good faith and no damage to the cestui can be shown. As Judge Cardozo pointed out, these considerations constitute

> no sufficient answer by a trustee forgetful of his duty. The law "does not stop to inquire whether the contract or transaction was fair or unfair. It stops the inquiry when the relation is disclosed, and sets aside the transaction or refuses to enforce it, at the instance of the party whom the fiduciary undertook to represent, without undertaking to deal with the question of abstract justice in the particular case" [citing cases]. Only by this uncompromising rigidity has the rule of undivided loyalty been maintained against disintegrating erosion.[10]

Until the instant case, the decisions limiting directors to cost for claims purchased during insolvency considered irrelevant the questions whether the insider acted in good faith and whether the

[10] *Wendt* v. *Fischer*, 243 N.Y. 439, 443-444, 154 N.E. 303, 304 (1926). See also *Meinhard* v. *Salmon*, 249 N.Y. 458, 464, 164 N.E. 545, 546 (1928).

debtor suffered any injury—and, indeed, most of these cases gave no consideration to whether the insider committed any overreaching or concealment in acquiring the claims upon which he is permitted no profit. The decision below has subjected a salutary principle to the very kind of "disintegrating erosion" against which Judge Cardozo warned.

* * * * *

Although the Commission's primary co cern with the decision below is the effect which it may have upon current and subsequent proceedings under Chapter X of the Bankruptcy Act, to which it is a statutory party, we feel strongly that this equitable principle must be recognized as equally applicable in any kind of insolvency proceeding in the federal courts. Respondent urged below, unsuccessfully, and we presume will argue in this Court, that in a Chapter XI proceeding the federal court has no jurisdiction to invoke the limitation to cost rule. This Court has said that the power to subordinate or limit claims is inherent in the powers of a court of bankruptcy as a court of equity. *Pepper* v. *Litton*, 308 U.S. 295, 306, 307.[11]

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[11] Provisions of the Act which do deal with breach of fiduciary relationship in other contexts specifically recognize the appropriateness of the sanction of limitation to cost. Cf. Sections 212 and 249 of Chapter X. It is clear that these provisions are not intended in any way to limit either the scope or the applicability of the broad equitable principles from which they are derived. See *In re Midland United Company*, 159 F. 2d 340 (C.A. 3); *In re Mountain States Power Co.*, 118 F. 2d 405 (C.A. 3); and *In re Los Angeles Lumber*

In addition, Chapter XI provides that when a voluntary petition is filed thereunder by the debtor, the court's jurisdiction, powers and duties shall be the same as if the proceeding were one in straight bankruptcy,[12] and this doctrine has been consistently applied by federal courts in straight bankruptcy proceedings. See *Monroe* v. *Scofield*, 135 F. 2d 725 (C.A. 10); *In re Jersey Materials Co.*, 50 F. Supp. 428 (D. N.J.). Moreover, under Section 366 the court is charged with the duty of determining that the arrangement is "fair and equitable" and accordingly, an arrangement which did not follow equitable principles of distribution should not be confirmed.

Products Co., 46 F. Supp. 77, 92 (S.D. Cal.). As was pointed out in the last cited case:

> Whether or not the specific language used in these sections [Section 77B, sub. b. and in Section 212 of Chapter X] is sufficiently broad to include the acts of Mr. Faries in the instant case, is beside the point. The very remedy provided in those sections has long been recognized and applied in the exercise of the general equitable power of the bankruptcy court. See *Bonney v. Tilley, supra* [109 Cal. 346, 42 Pac. 439 (1895)]; *In re Norcor Mfg. Co., supra. Cf. In re McEwen's Laundry, Inc.*, 6 Cir., 1937, 90 F. 2d 872.

And compare the state cases in which this rule has been recognized and applied as an incident of the courts' inherent equity power. *Bramblet* v. *Commonwealth Land & Lumber Co.*, 26 Ky. L. Rep. 1176, 83 S.W. 599 (1904); *Bulkley* v. *Whitcomb*, 121 N.Y. 107, 24 N.E. 13 (1890).

[12] See Sections 312 (2) and 322, Bankruptcy Act, 11 U.S.C. §§ 712, 722.

II

Where Claims Are Purchased During Insolvency by a Director Acting Within His Sole Discretion as Agent for His Wife and Mother, and by an Office Associate With the Assistance of the Director, Such Claims Must Be Treated as If the Director Had Purchased Them for Himself

We believe that the decision of the court below opens new avenues of evasion of equitable limitations applicable to a fiduciary by holding that these limitations do not apply to close relatives or business associates of a fiduciary who act with his knowledge and assistance. The majority below held that even on the assumption that the insider himself would be limited to cost, an extension of the limitation-to-cost rule would be required in order similarly to limit the claims of the respondents, because they "were not directors or officers of the debtor; their own funds were invested, and no officer or director of the debtor has any interest in the debentures they purchased" (R. 185).[13] The court

[13] In allowing the claims the court below relied strongly upon the decision in *In re Philadelphia & Western Ry. Co.*, 64 F. Supp. 738 (E.D. Pa.) in which the claims of McKernan, an officer of a corporation which had a management contract with the debtor, and Stoughton, the father of an officer of the debtor, were allowed without limitation. We disagree with the *Philadelphia and Western* case insofar as that case held that McKernan was not a fiduciary of the debtor despite her management contract and insofar as Stoughton was not held to have the burden of establishing that his son had not furnished him with any inside information or assistance. We do not, however, regard the *Philadelphia and Western* holding to be directly in point where there is an unquestioned fiduciary relationship and clear proof of advice and assistance by the fiduciary in the purchases by respondents. *Cf. In re Midland United Co.*, 64 F. Supp. 399, 416 (D. Del.).

then enunciated the general rule that claims of relatives and business associates should be limited only where it is shown that they have "knowingly confederated" in a breach of trust by the fiduciary.

Applying this doctrine to the instant case, the court held with respect to Fribourg, the business associate, that "investing one's own funds on a 'tip' received from an officer or director of a debtor" was not "knowingly confederating" with a fiduciary in a breach of trust (R. 185). As to the Becker ladies—the wife and mother of the director who acquired the debentures for them—the court found that although they are chargeable with the knowledge and equities of the director since they exercised no independent judgment in the investment of their funds, nevertheless the disciplinary sanction for "knowingly confederating" with a disloyal fiduciary should not be imposed since there was no overreaching of the sellers when the fiduciary made the purchase for his principals.

In our view this decision is inconsistent with the ultimate purpose of the limitation-to-cost rule and invites its circumvention by permitting the insider to utilize his special information, advice and assistance on behalf of relatives and close business associates.[14] To restrict the scope of the rule to cases

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[14] An indication of how wide this avenue of evasion can become is illustrated by the facts in *In re Franklin Building Co.*, 83 F. Supp. 263 (E.D. Wis.), appeals pending in C.A. 7. In that case the claimants are the wife, daughter, and son of a fiduciary of the debtor and its bondholders. Purchases for the wife and daughter were made by the fiduciary while the

where associates and relatives have been guilty of "knowingly confederating" with a fiduciary in the sense used by the court below is to dilute greatly the deterrent effect of the rule. The holding serves as a precedent for permitting fiduciaries to do indirectly what they may not do directly, and, if applied in other cognate situations, could do much to thwart one of the major objectives of the reforms in reorganization practice embodied in the Chandler Act.[15]

As we have argued in Part I above, we conceive that the rule is designed to deter director-fiduciaries from placing themselves in a position where they may be tempted to violate their obligation of undivided loyalty when, because of insolvency, their fiduciary obligations are broadest. Similarly, therefore, it would seem that the basic determinant as to the application of this rule to purchases by

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debtor was insolvent and during and subsequent to prior reorganization proceedings completely within his own discretion with funds belonging to the ladies. During the same period some of the son's purchases were made by the father and the remainder were purchased by the son entirely upon the father's judgment. Moreover, many of the bonds were purchased by the father and son with moneys which came from a single safe in the law and real estate offices shared by them. The district court limited the claims of the husband and father because he was a fiduciary but, adopting an attitude even narrower than the one reflected in the opinion below, allowed the claims of the son, wife and daughter in full.

[15] See H. Rep. No. 1409, 75th Cong., 1st Sess. p. 37 (1937), where it is stated that a major objective of the reforms was to prevent abuses whereby "the financial wellbeing of investors and the public" was "sacrificed to the insiders' desires for protection and for future profit."

relatives and business associates of the fiduciary after insolvency should be whether or not the "tendency to evil" at which the rule strikes exists in a given situation. The rationale underlying the application of the rule in such cases is not the imposition of sanctions or penalties for the personal misconduct of the persons presenting the claims. Rather, it is the recognition of the effect upon the fiduciary's motivation where he is left free to facilitate the realization of trading profits by close relatives and associates.

It is unrealistic and destructive to the operation of the limitation-to-cost rule to argue that the temptation for a fiduciary to be disloyal exists only when he has the kind of a financial interest which property or tax laws might recognize. There are many other equally compelling personal interests which, as a practical matter, produce fully as much pressure on trustees. This is especially true where the fiduciary's opportunity to make a direct profit from a diversion of loyalty is proscribed by well-settled principles of law.

Where a wife is involved, the nature and extent of the director's personal interests which are in conflict with the interests of his beneficiaries stand out most clearly. In view of the economic realities of American family life (which Congress has taken into recognition in the present income, gift, and estate tax laws) it is apparent that a husband has a financial interest, even though it may be in-

direct, in seeing his wife's separate estate increased. As stated in *In re Midland United Co.*, 159 F. 2d 340, 347 (C.A. 3), where an attorney was denied a fee from the estate because, among other things his wife traded in the securities of a subsidiary of the debtor in reorganization during the course of the reorganization:

> It will be noted that we have regarded Mrs. Evans' transactions as being in the same category as those of Mr. Evans. While she financed her securities dealings entirely with her own funds, Mr. Evans candidly stated that she engaged in the various transactions with his "entire approval and knowledge." Under such circumstances it is clear that the bankruptcy court was justified, in the exercise of its proper powers, in extending the principles applicable to the conduct of the fiduciary to the fiduciary's wife. The settled rule in equity is that where a fiduciary is barred from compensation the prohibition extends to his wife . . .[16]

In the instant case the circumstances are even stronger than in the *Midland* case where the purchases were made with the fiduciary's "entire approval and knowledge" (159 F. 2d at 347). Here the wife "exercised no independent judgment" in

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[16] See also *Holman* v. *Ryon*, 56 F. 2d 307, 311 (C.A D.C.); *In re Inland Gas Corp.*, 73 F. Supp. 785 (E.D. Ky.); *In re Fulton's Will*, 253 App. Div. 494, 2 N.Y.S. 2d 917 (1938); *Gunther* v. *Gove*, 275 Mass. 235, 175 N.E. 464 (1931); *cf. In re Los Angeles Lumber Products Co.*, 37 F. Supp. 708 (S.D. Calif.).

the purchase of the bonds; they were purchased for her by the director (R. 185).

The purchases made for Becker's mother stand upon substantially the same basis, in relation to the policy of the rule, whether we look to expectation of inheritance, recognition of a moral obligation of support or merely a filial affection as motivating the fiduciary's assistance in making the purchase. Nor should the line be drawn with close relatives so as to exclude purchases by a close business asociate, such as Fribourg.[17] Such relationships commonly involve not only close ties of affection but also the expectation, if not specific understanding, of receiving reciprocal advantages for making available to the business associate investment opportunities which the fiduciary may regard himself, for one reason or another, as precluded from realizing.

We believe that the court below failed to recognize the importance of these factors in the context of this prophylactic rule. Certainly where, as here, claims are acquired on the basis of a fiduciary's information, and with his advice and assistance, and the relationship between the claimant

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[17] This case does not present the problem of under what circumstances equitable sanctions should be imposed to discourage purchases by relatives or associates of the trustee in the absence of any evidence that the fiduciary advised or assisted in connection with such purchases. We believe that, as a minimum, the person whose close relationship to the fiduciary warrants an inference that he may have received inside information or assistance would have the burden of establishing the contrary.

and the fiduciary is such that an interest of the type discussed above must be presumed to exist,[18] all of the forces underlying the limitation-to-cost rule come into play. We submit that the rule can be effective only if the claimant in such cases is treated as standing in the shoes of the fiduciary, without regard to any active aiding, abetting or "confederating" on his part.[19] We believe that there is no hardship in making the acceptance by the third person of the gratuitous assistance from the fiduciary subject to the very same limitations with respect to realization of profit as if the fiduciary had traded for his own account.

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[18] The court below apparently attributed no significance to the fact that all three claimants had been instrumental in securing control of the debtor by these directors through participation in loans to the debtor at the directors' request (R. 71-72; 178-179).

[19] Even if the sanction of the rule were made to depend upon some active participation by the relative or associate in a fiduciary's breach of trust, we believe that in this context it is a breach of trust upon the fiduciary's part to arrange or facilitate by relatives or business associates the purchases he is precluded from making for his own account, and that "knowing confederation" is involved in the acceptance of advice and tips from the person known to be an officer and a director. It is not necessary, we believe, that the recipient of advice also know that the corporation is insolvent, since in accepting the insider's tip or guidance he should be chargeable with all the information known to the insider—particularly where as in this case the price paid for the security is indicative of financial distress if not of actual insolvency.

CONCLUSION

For the above reasons the Commission submits that the decision of the court of appeals should be reversed.

Respectfully submitted,

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